

September 25, 2006



## Financing OPEB

*Presented to:*

California Debt and Investment  
Advisory Commission  
Pre-Conference Workshop

*Presented by:*

Jenna Magan, Partner  
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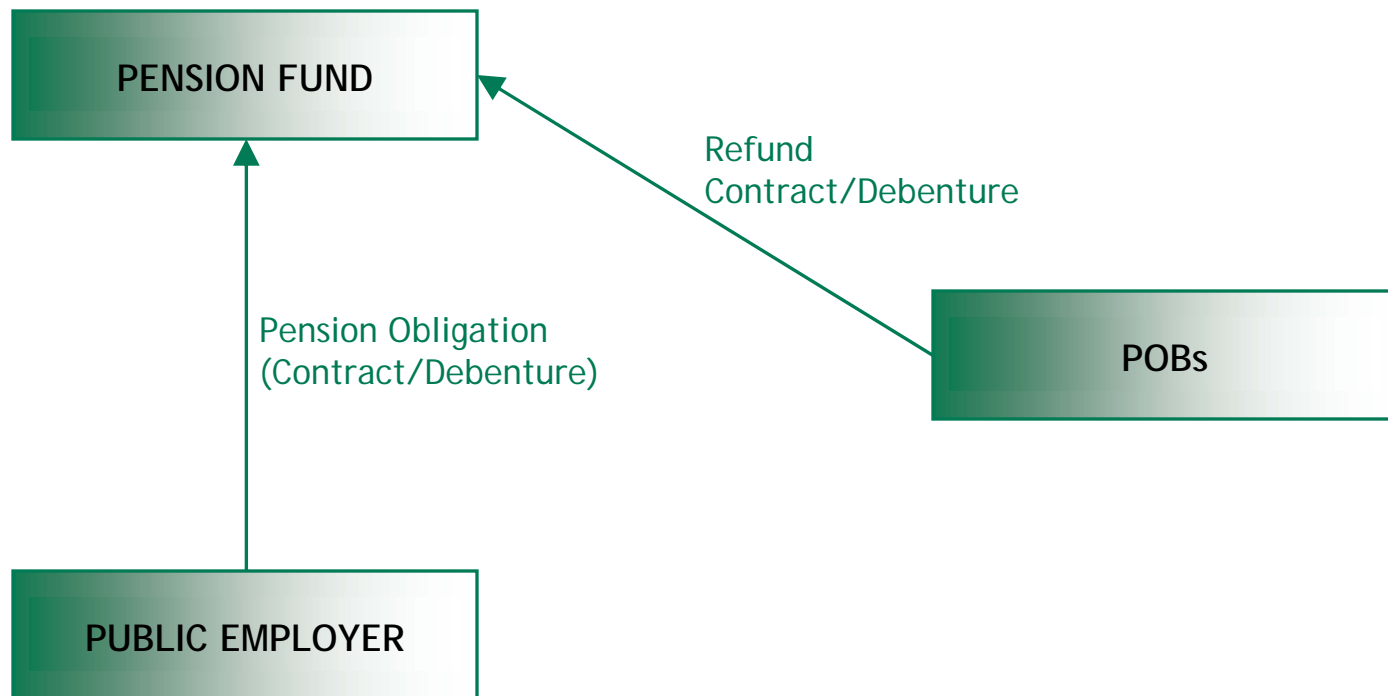
# Options for Addressing OPEB Liabilities

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- Renegotiate, change, eliminate or otherwise reduce benefits
- Continue pay-as-you-go
- Undertake a funding program
  - Deposit moneys in an internal reserve fund
  - Deposit moneys in a GASB qualified trust
    - ◆ of the annual required contributions or “ARC”
    - ◆ of more than the ARC to fund the accrued unfunded liability (in whole or part)
      - ❖ use bond financing

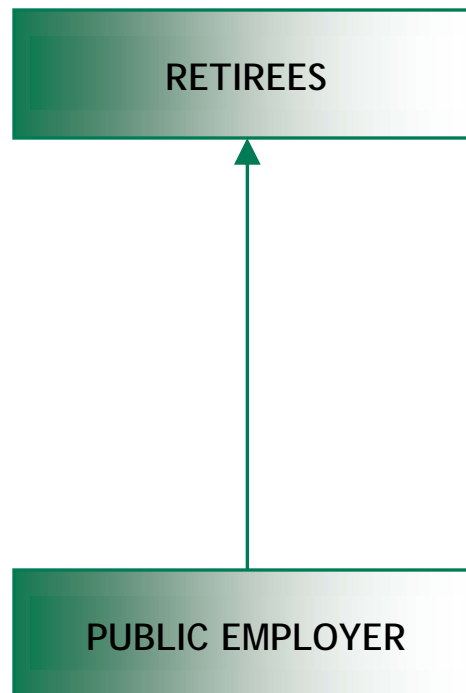
# Pension Obligation Bonds (POBs)

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# OPEB Obligations

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## Incentives to Establish OPEB Trusts

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- GASB 45 will only recognize an employer contribution if it is:
  - Irrevocably transferred to qualifying trust or equivalent
  - Solely used to provide OPEB benefits
  - Legally protected from creditors
- Higher Investment Return Assumption
- Rating Agency Benefit

## Types of OPEB Trusts

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- 401(h) Accounts
- 115 Trusts
- 501(c)(9) Voluntary Employees' Beneficiary Association Trusts ("VEBA")

## 401(h) Accounts

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- A separate account in a pension fund
- Amounts in the 401(h) account may not be used for any purpose other than retiree health benefits, not even other kinds of OPEB or pension benefits
- Amendments to statutes or documents governing the pension or retirement system generally required to authorize 401(h) accounts
- Contributions cannot exceed 25% of contributions to the pension fund after the date on which the account was established — meaning that, from the start date of the 401(h) account, contributions to the pension benefits component of the fund must be at least 3 times the amounts contributed to the 401(h) account

## 115 Trusts

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- This type of trust is considered exempt from federal income tax because it serves an “essential government function”
- Very flexible; can be used for a wider range of OPEB liabilities than a 401(h) account
- Single employer trust or multiple employer trust
- No limit on amount that may be invested
- Several 115 multiple employer trusts have been created:
  - California Community Colleges
  - California School Boards Association
  - Pending: PERS (SB 1729)
  - Pending: 37 'Act Counties (AB 2863)



## 501(c)(9) Trusts

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- Voluntary Employees' Beneficiary Association (VEBA) Trust
- Primary vehicle used in private sector for OPEB
- Must be “voluntary” and “controlled” by its membership

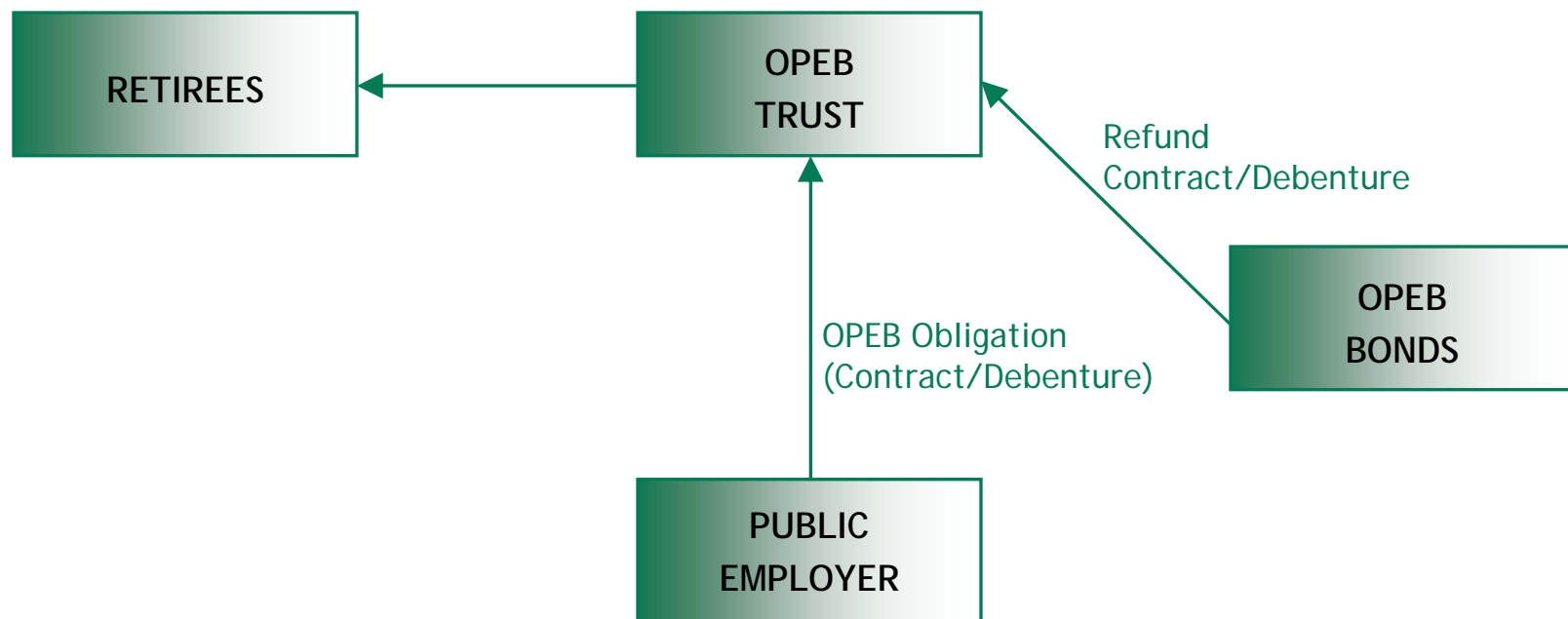
## Crucial Trust Characteristics

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- Exemption from Federal and State Income Tax
- Qualified Trust for GASB 45 Purposes
- Broad Investment Powers, Including Equities

# OPEB Bonds

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## OPEB Bonds — Legal Authority

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### Need Authority for Public Employer to Issue Bonds for This Purpose

- General Refunding Bond Law
  - California Counties, Cities and School Districts — Subject to Constitutional debt limit
    - ◆ “Obligation imposed by law” (analogy)
    - ◆ Validation Action required
  - Other California Local Governments (special districts, authorities) — Not subject to constitutional debt limit
    - ◆ Validation Action may not be required
- Subject to Appropriation
- Lease Financing

## Bottom Line

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- There are a number of steps before OPEB Bonds
- OPEB Bonds are taxable for federal tax purposes
- In most cases, there should be a way to issue OPEB Bonds

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